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IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1934.

No. 338.

DAVID H. JENNINGS, RECEIVER OF THE NATIONAL BANK OF AMERICA, AND NATIONAL BANK OF AMERICA,
Petitioners,

v.

UNITED STATES FIDELITY AND GUARANTY COMPANY,
Respondent.

SUPPLEMENTAL BRIEF BY RESPONDENT.

MR. SAMUEL O. PICKENS,
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MR. ARTHUR L. GILLIOM,
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FOREWORD.

Since Respondent's brief opposing certiorari was filed the Comptroller of the Currency filed a brief, *amicus curiae*, urging a decision on "the tracing of funds issues of law involved," regardless of outcome, and certiorari was granted.

This supplemental brief with Respondent's original brief will constitute its brief on the merits. The present brief goes chiefly to the Comptroller's brief.

SUMMARY OF ARGUMENT.

PROPOSITION I.

The proceeds received by the agent bank in payment for Respondent's item augmented the cash funds of the bank, and, as a part of such cash funds, they are traced into the cash funds now held by the Receiver.

Point 1.

The Comptroller's statement (p. 4) that no part of the cash funds in the Receiver's hands came to the bank from the collection transaction in question is erroneous. The statement completely ignores the fact that the item was collected by the bank as Respondent's agent in strict conformity with the agency authority conferred in Sec. 9 of the Indiana Uniform Bank Collection Code of 1929, and that under the terms of said Sec. 9 the agent bank received "in payment" for the item "proceeds" which to the bank were the equivalent of money and for which it did not become a debtor to Respondent.

> Secs. 3861.2, 3861.9, Vol. IV, Burns' Ann. Ind. Stat., 1929 Supp. (In Appendix to first brief.)

The parties had not contracted otherwise (R. 18-21) and it is, therefore, presumed that they dealt with respect to the applicable state statute. *Federal Reserve Bank v. Malloy*, 264 U. S. 160, 164. Such commercial transactions engaged in by National banks are

controlled by state law. *Dakin v. Bayly*, 54 Sup. Ct. Rep. 113, 114, 115; *McClellan v. Chipman*, 164 U. S. 347, 356, 357; *Lewis v. Fidelity and Deposit Company*, 54 Sup. Ct. Rep. 848, 851.

Point 2.

The agent bank's cash funds were *augmented* by the exact amount of the proceeds collected by it on Respondent's item. Under express authority of said Sec. 9 the agent bank collected the item through the Gary clearing house and received "in payment," without becoming debtor therefor, certain checks drawn upon itself (a form of payment authorized by Sec. 9), in the total amount of which were involved the original form of the proceeds from the item collected. Such proceeds forming a part of the checks received in exchange were the same as cash to the agent bank, and it is stipulated and found (R. 23) that but for receipt of these exchanged checks the bank would that day have paid to the clearing house the exact amount of Respondent's item more than it actually did pay. The legal effect of the transaction was that the agent bank had received "in payment" for Respondent's item the full amount in a form expressly authorized by said Sec. 9, and that as a result the bank had exactly $2,196.89 more in its cash funds than it would otherwise have had. When such is the result there is true augmentation.

Ellerbe v. Studebaker Corporation of America, (4 C. C. A.) 21 Fed. (2d) 993, 997.

Point 3.

Means exist in the facts for ascertainment of the *trust res*, in substituted form, in the hands of the Receiver.

The item in collection was the original *trust res.* The next form of the *res* is found in the exchanged checks which, to the amount of Respondent's item, had been received "in payment" by the agent bank. A necessary result of the charging by the agent bank of the exchanged checks to the accounts of the drawers, in view of the continued agency relationship under Sec. 9, was that in legal effect an equivalent amount of the bank's cash funds became immediately substituted for the *trust res* which had been embodied in the total amount of the exchanged checks. Thus, the *trust res*, in altered form, is located in the total of the cash funds of the bank. Under Sec. 9, the bank remained a fiduciary as to $2,196.89 of the cash funds in its possession.

Only a half business day intervened between the day of collection, Dec. 31, 1931 (R. 23), and the day of the bank's suspension, Jan. 4, 1932 (R. 17). The total of said cash funds never receded below the trust fund of $2,196.89 after the collection was made, and the cash funds now in the Receiver's hands exceed that sum (R. 26).

The presumption is that the bank kept sacred the trust fund involved in its total cash funds, and that any payments it may have made in the brief time remaining before suspension (none shown) would have been made out of that part of the total of its cash funds which was unrestricted.

Schumacher v. Harriett, (4 C. C. A.) 52 Fed. (2d) 817, 818, 819;
Central National Bank v. Insurance Co., 104 U. S. 54, 68.

PROPOSITION II.

The *trust res*, in altered form, having been ascertained as constituting a part of the total cash funds now in the Receiver's possession, equity will separate it *in amount* and order it paid to its rightful owner.

Schumacher v. Harriett, (4 C. C. A.) 52 Fed. (2d) 817, 818, 819;
Central National Bank v. Insurance Co., 104 U. S. 54, 69;
Conf. St. Louis & S. F. R. R. v. Spiller, 274 U. S. 304, 309, 310.

PROPOSITION III.

The Comptroller's statement (p. 4) that Respondent's claim is given a "preferred status," whereas in the other circuits it would have a "general claim status" is incorrect.

Point 1.

The decision does not give Respondent a preference claim upon assets of the bank. The theory of the opinion and decision is that what is awarded to Respondent rightfully belongs to it and is not rightfully an asset of the bank, and the opinion expressly so says (R. 50).

Point 2.

No claim bottomed on a collection transaction made pursuant to the provisions of Sec. 9 of the Uniform Bank Collection Code, as is Respondent's, has been passed on by the courts of other circuits in any

of the cases cited by the Comptroller, and we can find none. It is, therefore, incorrect to say what the status of such a claim would be in other circuits.

PROPOSITION IV.

The Comptroller's statement (p. 4) that the decision in this case is contrary to the intent of the National Banking Act that liquidation of national banks be uniform throughout the United States, is incorrect.

Point 1.

This Honorable Court long ago said that the requirement as to ratable dividends is to make them from what belongs to the bank. *Scott v. Armstrong*, 146 U. S. 499, 510. Also, that the Act does not assume to appropriate trust funds, and that state courts have jurisdiction to determine whether particular funds are trust funds. *Capital Bank v. Cadiz Bank*, 172 U. S. 425, 433.

The instant decision is in harmony with the foregoing interpretation of the Act.

Point 2.

The results of the application of the identification rule must necessarily vary with the varying facts and relevant considerations in the cases where the rule is applied. And one such relevant consideration affecting the result may be the effect of such statutory provisions as are contained in Sec. 9 of the Uniform Bank Collection Code.

Recent decisions of this Honorable Court recognize permissible divergency in results in the liquidation of insolvent National banks as dependent on applicable provisions of state statutes. Compare, *Lewis v. Fidelity and Deposit Company*, 54 Sup. Ct. Rep. 848, and *City of Marion v. Ben Sneeden*, 78 Law Ed. 521.

PROPOSITION V.

The decision does not conflict with principles of law decided in the cases of this Court which the Comptroller cites. These will be examined in the argument.

PROPOSITION VI.

The opinion and decree properly rest on findings showing an identified *trust res* in possession of the Receiver. The decree would, however, be right without such identification in view of the trust which is impressed on the agent bank's assets by paragraph 3 of Sec. 13 of the statute under which the collection was made, regardless of whether the funds representing the proceeds can be traced and identified.

Sec. 3861.13 (3), Vol. IV, Burns' Ann. Ind. Stat., 1929 Supp., see Appendix hereto.

ARGUMENT

OF PROPOSITIONS I AND II (pp. 2, 5).

The Comptroller erred (p. 4) in saying that the decision went for Respondent "despite record proof that not one penny of such funds actually came into the bank from claimants' transaction." The Comptroller ignores the effect of an applicable state statute.

The Uniform Bank Collection Code was in force in Indiana when this collection was made (Sec. 3861.1-19, Vol. IV, Burns' Ann. Ind. Stat., 1929 Supp.).

The parties had not contracted differently from the provisions of said statute, and the presumption is that the parties contracted with reference to that statute. *Federal Reserve Bank v. Malloy*, 264 U. S. 160, 164. In virtue of Sec. 2 of said statute, National Bank of America became Respondent's subagent. The bank was an agent collecting bank within the meaning of Sec. 9 of said statute, and it made the collection of Respondent's item as such agent within the scope of the agency authority conferred on it in Sec. 9.

As a matter of general law such subagent bank would have had agency authority to receive only legal tender money in payment for the item. *Federal Reserve Bank v. Malloy*, 264 U. S. 160, 165.

But Sec. 9 of said statute authorized this agent collecting bank, acting as Respondent's subagent, to receive "in payment" for the item, in lieu of money, and without becoming responsible as debtor therefor, whether presented by mail, through the clearing house or over the counter of the drawee or payor, "either

(a) the check or draft of the drawee or payor upon another bank or (b) the check or draft of any other bank upon any bank other than the drawee or payor of the item or (c) *such method of settlement as may be customary in a local clearing house or between clearing banks or otherwise.*"

Payment was received by the agent bank for Respondent's item in a manner and form authorized under (c), *viz:* upon presentment of the item to the drawee bank through the Gary clearing house, the agent bank received in exchange checks totalling $11,470.19, drawn upon itself (R. 23).

Authorized payments in forms other than money are characterized as "proceeds" in a proviso to Sec. 9. Said proviso makes the agent bank a debtor if it requests or accepts in payment an unconditional credit which has been given to it on the books of the drawee or payor or on the books of any other bank. Otherwise, the proviso is here immaterial, for the conditions under which the agent bank would become a debtor did not exist.

Under the facts, and in virtue of said Sec. 9, the agent bank received *payment* for Respondent's item in the form of checks drawn upon itself and the proceeds from Respondent's item were, in their first form, involved in these exchanged checks, with the agency relationship still continuing. Sec. 9, of course, contemplated that if payment were received in the form of such checks that the agent bank might charge them against the drawers' accounts while it still remained such agent and while it still remained under a fiducial duty to remit the proceeds which it received "in payment." It follows, that upon the charging of such

checks to the accounts of the drawers a legal substitution of an equivalent amount of the agent bank's cash and cash items occurred for the proceeds which had been involved in the total of said checks, and that the agent bank remained a fiduciary in respect to the substituted form of the *trust res.* What the agent bank had received "in payment" for Respondent's item was the same as cash to it and became immediately reflected in its remaining cash and cash items.

This is not a case of a bank having left more cash and cash items on hand after a clearing house transaction as a result of the misuse of an item in collection to pay the agent bank's own debts in violation of the agency authority. This is a case where the agent bank *collected* the item in strict conformity with the agency authority conferred on it in said Sec. 9, and as a result of which it received "in payment" for Respondent's item the full amount. The effect is clearly such that as a result of such payment the agent's cash and cash items were augmented by that exact amount. Indeed, it is stipulated and found by the Court (R. 23) that but for this collection transaction the agent bank would have paid to the clearing house the exact amount of Respondent's item more than it did pay.

The provisions of Sec. 9 of said Code in no wise impaired the functions of the bank as a government agency and they were not in conflict with any Federal law, and they clearly applied to and controlled the transaction. *Lewis v. Fidelity and Deposit Company,* 54 Sup. Ct. Rep. 848, 851; *McClellan v. Chipman,* 164 U. S. 347, 356, 357; *Federal Reserve Bank v. Malloy,* 264 U. S. 160, 164.

When the true nature of the transaction and its legal consequences under said Sec. 9 are regarded, it

becomes plain that the cash and cash items of the agent bank were truly augmented by the exact amount of the proceeds from Respondent's item.

Such augmentation established, the proceeds of Respondent's item as first involved in the total amount of the exchanged checks are, under the principle of substitution above stated, in altered form clearly traced into the total of the agent's cash and cash items remaining after the clearing house transaction of December 31, 1931, which was the next to the last day the bank did business.

The bank's cash and cash items never receded below the amount of Respondent's item and the funds now in the Receiver's hands are in excess of that amount.

What the agent bank may have paid out during the less than a day and a half while it remained open for business after this collection was made (nothing shown) would presumptively have been paid out of the unrestricted portion of its funds. *Peoples Nat. Bank v. Moore*, (8 C. C. A.) 25 Fed. (2d) 599, 601; *Central National Bank v. Insurance Co.*, 104 U. S. 54, 68.

In these circumstances, under the modern rule governing tracing, the proceeds of Respondent's item, in altered form, are sufficiently ascertained as constituting a part of the cash funds in the Receiver's hands, and equity will order their separation and payment to Respondent as the rightful owner thereof. *Schumacher v. Harriett*, (4 C. C. A.) 52 Fed. (2d) 817, 818, 819; *Central National Bank v. Insurance Co.*, 104 U. S. 54, 69; *St. Louis & S. F. R. R. v. Spiller*, 274 U. S. 304, 309, 310.

OF PROPOSITION III (p. 5).

Respondent's claim is not given a "preferred status" in the sense that a preferred claim upon assets is allowed. The opinion expressly says (R. 50) that "The proceeds of appellee's check were not rightfully a part of its assets, and there is no effort here to secure a preference over any creditor in the distribution of the assets."

Neither was it correct for the Comptroller to say (p. 4) that such a claim, bottomed in part on applicable provisions of the Uniform Bank Collection Code as is Respondent's, has only the status of a general creditor claim in other jurisdictons. He cites no case, and we know of none, involving a claim thus bottomed that any other court has ever passed upon. What the courts in other circuits would hold in such a case is not known because they have not yet spoken.

The Comptroller overlooks the proposition that as a matter of general law a bank entrusted with an item for collection and remittance has agency authority only to receive legal tender money in payment. *Federal Reserve Bank v. Malloy*, 264 U. S. 160, 165. He also overlooks the distinction between a transaction where only the general law obtains and a bank, in violation of its trust, *converts* an item by using it in a clearing transaction for the purpose of paying its own debts, as in *Farmers Nat. Bank v. Pribble*, 15 Fed. (2d) 175, and a transaction, such as the instant one, where an agent bank acting strictly within its agency authority conferred by statute *collects* the item and receives something "in payment."

In the one instance the result is merely to decrease indebtedness by the wrongful use of the item held in

trust, while in the other instance the legal effect is that the agent bank actually receives proceeds in payment. In the one case the basis for augmentation is usually lacking, while in the other instance there is clearly augmentation by the amount received in payment whatever its form. And in the instant case, the form of the proceeds were such as to find immediate affirmative reflection in the agent bank's cash and cash items.

The Comptroller also overlooks the distinction between the instant transaction as governed by Sec. 9 of the Uniform Bank Collection Code and in which proceeds from the collection came to the agent bank from another bank and transactions governed by general law where the collecting banks were also the paying banks and a mere shifting of credits occurred, as in *City of Miami v. First National Bank*, 69 Fed. (2d) 346; *Allied Mills v. Horton*, 65 Fed. (2d) 708; *Larabee Flour Mills v. First National Bank*, 13 Fed. (2d) 330, and in other cases he cites.

Respondent contends that all decisions of other circuits cited, and which could be cited, rest on considerations of general law and not upon the practical legal effects imputed by Sec. 9 of the Bank Collection Code, and that under the facts and the law in the instant case the decision is correct.

OF PROPOSITION IV (p. 6).

No intent of the National Banking Act as to uniformity of liquidation of banks is violated by the instant decision. Ascertainable trust funds always go to the rightful owner, *Capital Bank v. Cadiz Bank*, 172 U. S. 425, 433, and only that which rightfully

belongs to the bank goes to creditors. *Scott v. Armstrong*, 146 U. S. 499, 510.

The results of the application of the rule that a *trust res* must be identified by its claimant either in original or altered form must, of course, depend on the particular facts and considerations in the case where the rule is applied.

Relevant considerations affecting the result of application of the identification rule in a particular case may, as here, be of the provisions of a State Uniform Bank Collection Code pursuant to which an agent collecting bank made the collection and received something "in payment" for the item. And if such considerations dictate a different result from what the result would be where the Code does not obtain and where the construction under general law would be that the bank entrusted with an item for collection violated its agency authority and misused the item for the purpose of paying its own debts, such divergency in results of the application of the identification rule would not violate any intent of the National Banking Act.

Occurrence of divergent results in different jurisdictions in the liquidation of insolvent National banks as dependent on state statutes is recognized in two cases recently decided by this Honorable Court. Thus, in *Lewis v. Fidelity and Deposit Company*, 54 Sup. Ct. Rep. 848, it was held that Georgia had a lien for state deposits on the assets of a failed National bank in view of certain provisions of a statute of that state; whereas Illinois, under similar facts, did not have such a lien because its depository

statute did not go so far as that of Georgia. *City of Marion v. Ben Sneeden*, 78 Law Ed. 521.

OF PROPOSITION V (p. 7).

The instant decision conflicts with nothing decided in *Schuyler v. Littlefield*, 232 U. S. 707, 713. The principle that trust funds may be recovered if satisfactorily traced is recognized but the requisite proof was not there present.

The rule stated in Note 19 to the opinion in *Pottorff v. Texas & Pacific R. Co.*, 291 U. S. 245, is not violated here, but is, indeed, complied with. The rule there stated is that "The claimant has the burden of identifying the property in its original or altered form." The opinion in the instant case expressly says the same thing in effect (R. 50).

In *Davis v. Elmira Savings Bank*, 161 U. S. 275, a New York state statute was held ineffective because it did not profess to deal with the bank and its relations as a going concern, but it "wholly and exclusively undertakes to regulate the distribution of assets after insolvency." The first twelve sections of the Uniform Bank Collection Code deal exclusively with banks as *going concerns*, and under the rule expressly recognized in the *Davis* case (p. 287) those sections do control the collection transactions of National banks as going concerns and operate to fix relations at the moment when suspension occurs.

The reference by the Comptroller to *Cook County National Bank v. United States*, 107 U. S. 445, 448, merely shows that the winding up of National banks is controlled by Federal statute. The instant decision is not in conflict with that principle.

OF PROPOSITION VI (p. 7).

Respondent's position, heretofore stated, is that a *trust res* of which it is the beneficial owner has been identified in the Receiver's possession. The decision under review is properly put on that ground by the opinion of the Circuit Court of Appeals.

But the decree would be right without such identification established in view of the trust which is impressed on the agent bank's assets by paragraph 3 of Sec. 13 of the statute under which the collection was made, regardless of whether the funds representing the proceeds can be traced and identified.

That paragraph of Sec. 13 (p. 20, Appendix hereto) impresses a trust on the assets of a failed non-debtor agent bank in favor of its principal for the amount of unremitted proceeds of a collected item, irrespective of whether the funds representing such item can be traced and identified as a part of such assets or has been intermingled with or converted into other assets of such failed bank, and the paragraph also provides that the principal shall have a preferred claim upon the assets so impressed.

Properly understood, the provisions in paragraph 3 of Sec. 13 are not in conflict with Federal law governing distribution of assets. These provisions do not deal with creditor interests and they apply only where the agent bank, as here, is not responsible as debtor for the proceeds of the collected item. The trust which is impressed is the same trust which arises under the provisions of Sec. 9 of the same statute at a time when the agent bank is a going concern. The provision for a "preferred claim" is not an effort to prefer a creditor out of anything belonging beneficially to the bank, but is merely a device adopted to secure to the principal

something which from the beginning is beneficially his. Hence, there is no conflict with the Federal law governing distribution of that which beneficially belongs to the bank.

Nor should equity have any difficulty here. These provisions go only one step farther than equity has gone in the absence of such agency authority as Sec. 9 confers for receiving payments in transmutable forms which can frequently not be traced and identified. That step is to secure to the beneficial owner the amount of collected proceeds, irrespective of tracing and identification of the fund representing such proceeds. This is a permissible step in view of the new step taken in Sec. 9 by which the agent may receive for the principal proceeds of transmutable type but which are none the less real in modern banking methods. Both steps taken by this statute are in recognition of modern business methods in such collection transactions. The step taken in Sec. 9 will, of course, be allowed, and the one taken in paragraph 3 of Sec. 13 ought also be allowed. The same power which gives the agent bank its exclusive authority to receive proceeds of that character without becoming responsible as debtor therefor ought also be able to make effective provisions in the same statute for effective preservation to the principal of the beneficial interest to such proceeds regardless of their transmutations.

The history of the court-made tracing and identification rule has itself been one of progressive adaptation to changing methods of doing business. The rigors of the original rule have become much relaxed, and earmarks are no longer required. Equity, always concerning itself more with substance than with form,

should find no difficulty in allowing the step taken in paragraph 3 of Sec. 13 in cases where, as here, the step is intended to apply. To do so only requires application of the maxim that equity follows the law.

Receipt of proceeds by a national agent bank under exclusive authority of Sec. 9 of the Uniform Bank Collection Code necessarily implies submission by the bank to the trust provisions contained in the statute. In effect there is an equitable lien provided in favor of the principal for the amount of the proceeds collected by the agent bank. The principle is established that where a National bank voluntarily enters into a permissible transaction which is governed by a state law which demands a lien on the bank's assets, such lien will be respected in liquidation proceedings. *Lewis v. Fidelity and Deposit Company*, 54 Sup. Ct. Rep. 848.

The validity of the argument that paragraph 3 of Sec. 13 should be given application is not impaired by the fact that in jurisdictions where the Uniform Bank Collection Code is not yet in force the tracing and identification rule must be observed. In those jurisdictions general law limits agency authority to the collection and remittance of legal tender money. The presumption is that these limitations will be observed in those jurisdictions, and if an agent bank violates the limitation and becomes trustee *ex maleficio* that would afford sufficient distinction for results in jurisdictions where such is the case different from what the results should be where the agent bank performs lawfully and becomes trustee under the statute giving the authority exercised.

It is respectfully submitted that an identifiable *trust res* has been ascertained in this case as constitut-

ing part of the total cash funds held by the Receiver and that the decision should be affirmed on that ground. If that view were not accepted, then the decision should be affirmed in virtue of the provisions in Sec. 13 of the Uniform Bank Collection Code.

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APPENDIX.

SECTION 13 OF UNIFORM BANK COLLECTION CODE, CH. 164, INDIANA ACTS OF 1929.

Procedure When Bank Fails or Is Closed for Business.

Sec. 13. (1) When the drawee or payor, or any other agent collecting bank shall fail or be closed for business by the state bank commissioner or by action of the board of directors or by other proper legal action, after an item shall be mailed or otherwise entrusted to it for collection or payment but before the actual collection or payment thereof, it shall be the duty of the receiver or other official in charge of its assets to return such item, if same is in his possession, to the forwarding or presenting bank with reasonable diligence.

(2) Except in cases where an item or items is treated as dishonored by nonpayment as provided in section 11, when a drawee or payor bank has presented to it for payment an item or items drawn upon or payable by or at such bank and at the time has on deposit to the credit of the maker or drawer an amount equal to such item or items and such drawee or payor shall fail or close for business as above, after having charged such item or items to the account of the maker or drawer thereof or otherwise discharged his liability thereon but without such item or items having been paid or settled for by the drawee or payor either in money or by an unconditional credit given on its books or on the books of any other bank, which has been requested or accepted so as to constitute such drawee or payor or other bank debtor therefor, the assets of

such drawee or payor shall be impressed with a trust in favor of the owner or owners of such item or items for the amount thereof, or for the balance payable upon a number of items which have been exchanged, and such owner or owners shall be entitled to a preferred claim upon such assets, irrespective of whether the fund representing such item or items can be traced and identified as part of such assets or has been intermingled with or converted into other assets of such failed bank.

(3) Where an agent collecting bank other than the drawee or payor shall fail or be closed for business as above, after having received in any form the proceeds of an item or items entrusted to it for collection, but without such item or items having been paid or remitted for by it either in money or by an unconditional credit given on its books or on the books of any other bank which has been requested or accepted so as to constitute such failed collecting or other bank debtor therefor, the assets of such agent collecting bank which has failed or been closed for business as above shall be impressed with a trust in favor of the owner or owners of such item or items for the amount of such proceeds and such owner or owners shall be entitled to a preferred claim upon such assets, irrespective of whether the fund representing such item or items can be traced and identified as part of such assets or has been intermingled with or converted into other assets of such failed bank.